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An inter se Modification of the ECT to Exclude Intra-EU Arbitration – How Can It Work?

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Several EU member states have abandoned the modernization of the ECT and expressed their intention to withdraw from the ECT (see here). In February 2023, a Commission non-paper was leaked, which describes a coordinated withdrawal of the EU and its member states from the ECT as the 'the most adequate option'. Such a coordinated withdrawal envisages an *inter se* modification of the ECT to exclude intra-EU investment arbitration and the applicability of the sunset clause in intra-EU relations. If the sunset clause is not removed *inter se,* investors from the EU could still bring investment claims against other EU states during the 20-year survival period after withdrawal (see here). To that effect, the Commission proposed a draft for a subsequent agreement to the ECT already in October 2022. However, reportedly some EU member want to stay in a modernized ECT and a proposal is being considered for a partial exit only. Irrespective of whether all or only some member states withdraw from the ECT, an *inter se* modification of the ECT to exclude intra-EU investment arbitration and the sunset clause between EU member states is considered necessary by many policy-makers, not least to implement the CJEU's *Komstroy* judgment (see here). Some EU member states have already notified their withdrawal to the depositary of the ECT and thus even the modernization of the ECT could no longer exclude intra-EU arbitration for all EU members.

I have previously expressed skepticism about the legality of an *inter se* agreement to exclude intra-EU arbitration and the sunset clause (see here and here) and argued that the modernization of the ECT is a preferable way to avoid these problems. However, given the political realities, a workable solution for an *inter se* modification to remove intra-EU arbitration must be found.

This blogpost considers how such an *inter se* modification might be adopted in manner that complies with international law and is accepted by arbitral tribunals. It first outlines the substantive legal problem with the proposed *inter se* modification before addressing a way in which the problem can be remedied. Subsequently it outlines the procedural requirements for an *inter se* modification.

Substantive Requirements for a Lawful *Inter Se* Modification

According to Article 41 VCLT a group of contracting parties to a multilateral treaty may agree to modify that treaty between themselves if it is explicitly provided for or not explicitly prohibited

(Article 41(1) VCLT). Some tribunals (*Vattenfall* (II) para. 221; *Eskosol* para.151) have deduced an explicit prohibition from Article 16(2) ECT. This non-derogation clause provides that any subsequent agreement by some contracting parties concerning the investment protection standards or investor-state dispute settlement shall not be construed to derogate from the protection standards and the right to dispute resolution under the ECT.

Even if an *inter se* agreement is not considered outrightly prohibited by Article 16(2) ECT (*Silver Ridge* para. 228), it must not affect the rights of other contracting parties pursuant to Article 41(1)(b)(i) VCLT (which is unproblematic here) and 'not relate to a provision a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole' (Article 41(1)(b)(ii) VCLT). That threshold is high and commentators (see e.g. von der Decken; ILC Fragmentation report) have usually distinguished between absolute or interdependent rights, such as in human rights treaties, and reciprocal or bilateral rights. They essentially argue that only in the case of absolute or interdependent rights an *inter se* agreement would be prohibited. Virtually all provisions of the ECT concern bilateral rights, in other words the ECT is a web of bilateral investment treaties. However, nothing in the final text of the VCLT or the ILC draft commentary to the VCLT necessarily suggests that only *inter se* agreements affecting absolute rights can fall within the scope of (Article 41(1)(b)(ii) VCLT) and arbitral tribunals have not adopted such an interpretation.

In general, the object and purpose of the ECT may be derived from the preamble and Article 2 ECT, referring to the purpose of the ECT as 'establish[ing] a legal framework in order to promote long-term co-operation in the energy field'. At least one tribunal, when discussing Article 2 ECT, viewed the removal of intra-EU arbitration as contrary to the ECT's objective to promote the flow of foreign direct investment in the energy sector (*Vattenfall* (II) para. 198).

However, the language in Article 2 ECT is rather general and does not by itself establish that intra-EU investment arbitration is the pivotal element of the ECT . In connection with the argument of an alleged *inter se* modification of the ECT through the EU Treaties, tribunals have taken into account other provisions for the assessment under Article 41(b)(ii) VCLT, in particular Article 16 ECT and rejected the purported *inter se* modification as impermissible (see e.g. *Sevilla Beheer* para. 650; *Mercuria* para. 413). Emphatically, the tribunal in *BayWa* (para. 276) noted that

it is very doubtful whether the abrogation inter se of the ECT as between EU Member States is compatible "with the effective execution of the object and purpose of the [ECT] as a whole". Article 16 of the ECT suggests that it is not, since it evinces an intent, even as between treaties on the same subject matter, to preserve the rights of investors and investments, which constitute a major plank of that multilateral treaty.

Thus, there is a risk that arbitral tribunals would regard an *inter se* modification as incompatible with the ECT, primarily because of Article 16 ECT as this provision apparently shows that access to investment arbitration is the essential feature of the ECT (see also the recent article by Morgandi & Bartels).

Making the *inter se* Modification Work

These interpretations by arbitral tribunals are an obstacle to an *inter se* modification, but do not necessarily render it impossible. Arguably an *inter se* agreement could be permissible if it is sliced up into two agreements: first, an *inter se* agreement to remove Article 16 ECT; second, an *inter se* agreement to exclude access to intra-EU arbitration and the sunset clause. The mere modification of Article 16 *inter se* does not directly remove access to intra-EU arbitration, which only follows as a second step. It is true that this *de facto* circumvents the limitations imposed by Article 16 ECT, but formalistically is not objectionable. In addition, such a two-step arguably requires the entry into force of the first *inter se* agreement before the second *inter se* agreement can be adopted in order to ensure that Article 16 ECT indeed has no effect. This results in a prolonged time-period before intra-EU arbitration is removed, but would be evidence of a good faith approach to the desired *inter se* modification of the ECT. In addition, the *BayWa* tribunal acknowledged that Article 16 ECT could be removed *inter se* (cf *BayWa* para. 282). Accordingly, the removal of Article 16 ECT *inter se* would place the envisaged *inter se* agreement of the EU on safer legal grounds.

Procedural Requirements for a Lawful *Inter Se* Modification

The procedural requirements for an *inter se* modification cause fewer troubles than the substantive limitations of Article 41 VCLT, but are somewhat unclear since Article 41 VCLT offers limited guidance. According to Article 41(2) VCLT all contracting parties must be notified of the intention of the conclusion of an *inter se* modification and its content. This is an important step as other parties to a multilateral treaty must be given the opportunity to participate in an *inter se* modification. In order to avoid any miscommunication, it might be best to follow the procedure set out in Article 42 ECT for regular amendments by analogy and communicate the proposed *inter se* agreements to the secretariat of the ECT, which shall then forward them to all contracting parties (Article 42(2) ECT).

No timelines are mentioned in Article 41 VCLT for the notification and conclusion of the *inter se* modification, but an orderly process requires at least some months between notification and conclusion of the *inter se* agreements. Other VCLT provisions foresee notice periods of 12 months (e.g. Article 56(2) VCLT or 3 months (e.g. Article 65(2) VCLT). Again, it might be best to apply the notice period for regular amendments of the ECT under Article 42(2) ECT by analogy. This means that a notice period of at least three months between communication from the secretariat to contracting parties and the formal adoption of the *inter se* agreements must be observed.

At least one tribunal has linked the procedure for an *inter se* agreement to exclude intra-EU arbitration with the requirements set out in Article 42 ECT (*Sevilla Beheer* para. 670). In order to render Article 41 VCLT not completely meaningless, this reference to Article 42 ECT cannot be understood as requiring a ratification of three-fourths of the contracting parties since it does not concern all ECT states and thus it should not require the convening of a Charter Conference or a 90-day period for entry into force of *inter se* agreement either.

Conclusion

While the modernization of the ECT would remove access to intra-EU arbitration in a

straightforward manner (Article 24(3) modernized ECT), an *inter se* modification to exclude access to intra-EU arbitration and the sunset clause has become inevitable given the preference for withdrawal by several EU member states. However, in order to make such an *inter se* amendment less contestable, Article 16 ECT should first be deleted *inter se* and some procedural requirements set out in Article 42 ECT should be followed. This will ensure, to the greatest extent possible, that arbitral tribunals will effectively decline jurisdiction in future intra-EU investment disputes.

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